



*Rosalind M. Hewsenian  
Managing Director*

August 23, 2005

Mr. Mark Anson  
Chief Investment Officer  
California Public Employees' Retirement System  
400 P Street  
Sacramento, CA 95814

Re: Global PREES Policy

Dear Mark,

You had requested Wilshire's opinion with respect to Staff's recommendation to revise the Extended Market PREES investment policy to include non-US real estate securities to achieve a global exposure to this sub-component of real estate. Wilshire has reviewed the investment policy amendment proposal and concurs with Staff's recommendation.

#### **Discussion**

Wilshire has long been a proponent of publicly-traded real estate securities for their income yield, diversification characteristics, and relatively low risk compared to other forms of equity and private real estate. Many of the other developed countries in the world are changing laws to create real estate investment trust-type (REIT) structures through which an investment in real estate can be offered. This non-US REIT market is still in its nascent state of development, though that is when the opportunity to earn the highest returns can be captured. It is also the period of highest risk. However, Wilshire believes that it is a risk easily borne by CalPERS because, as a percentage of total assets, any non-US REIT exposure would be small.

Wilshire also supports the implementation approach through external management. External management can be used initially while CalPERS works with the managers and learns about the marketplace with the goal of eventually developing internal capabilities. However, few managers have global REIT performance records and experience. Therefore the RFP process to solicit global REIT managers may not necessarily yield many candidates initially. It shall be important to discern real experience from those managers that want the opportunity to expand into non-US REITs. A carefully-crafted RFP process can address this matter.

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Staff outlined many risks in its memo of justification. However, there are two that Wilshire believes are the most significant: liquidity risk and diversification risk.

Liquidity Risk. Though far more liquid than private real estate, non-US real estate securities do not have nearly the average daily trading volume of publicly-traded conventional non-US equity, even compared to the non-US small capitalization portion of the market. Therefore, the significance of exposure will be small. Positions will have to be built slowly with a longer average holding period than conventional equity. Transaction costs will be higher for conventional non-US REITs than those of US REITs because of the cost of "market impact" of trading.

Diversification Risk. Sufficient country diversification is difficult to achieve in the non-US REIT market as not all countries offer a REIT structure in their equity market. As a result, some countries may be disproportionately represented compared to the general non-US equity market. An example is Australia, which is a country that is strongly represented in the non-US REIT marketplace. Thus employing a global strategy where diversification into the US with investment in non-US REITs opportunistically can attenuate the diversification risk of non-US real estate securities.

In conclusion Wilshire supports a global PREES concept and supports Staff's recommendation. Should you require anything further, please do not hesitate to contact me.

Sincerely,

Handwritten signature of R. M. Lusenian in cursive script.